I. APPLICATIONS FOR DEPOSIT INSURANCE

Introduction

The granting of deposit insurance confers a valuable status on an applicant institution; its denial, on the other hand, may have seriously adverse competitive consequences, and, in the case of a new institution, may effectively preclude entrance into the banking/thrift business. Obviously, the role of the FDIC, in acting upon such applications, involves important responsibilities and the exercise of sound discretion in the public interest.

Sections 5 and 6 of the Federal Deposit Insurance Act specifically deal with admission to deposit insurance coverage. Section 5 states that before approving an application, consideration shall be given to the factors enumerated in Section 6. Those factors are: the financial history and condition of the bank, the adequacy of its capital structure, its future earnings prospects, the general character of its management, the risk presented to the insurance fund, the convenience and needs of the community to be served, and whether or not its corporate powers are consistent with the purposes of the Act.

Various sections of Part 303 of the FDIC's Rules and Regulations implement the basic statutory provisions and govern the administrative processing of applications for deposit insurance. Of particular significance to examiner personnel is the provision allowing public access to the nonconfidential portions of the file in connection with applications for deposit insurance coverage by new institutions. The nonconfidential material includes, among other things, the future earnings prospects and the convenience and needs portions of the field examiner's investigation report. Applications for deposit insurance by existing institutions are not expressly covered by Part 303.

Rights of Applicants

An applicant has a statutory right to apply for deposit insurance and to obtain full consideration of its application by the FDIC in light of all relevant facts and without prejudice. If all of the seven statutory factors are resolved favorably, the applicant is entitled to receive deposit insurance coverage. In the event an application is disapproved, an applicant has a right to be informed by the FDIC of the reasons for disapproval.

Obligations of the FDIC

Under applicable law, the FDIC is obligated to consider the seven factors enumerated in Section 6 of the FDI Act in connection with every application for deposit insurance. As a measure of protection against unwarranted and unjustified risks, a full and thorough examination or investigation of each application is conducted. The FDIC has formulated certain guidelines for admission, which are designed to ease administrative problems, aid in preventing arbitrary judgment, and assist in assuring uniform and fair treatment to all applicants. These guidelines must, however, be administered in a manner consistent with the spirit of the Act, and the maintenance of a competitive and free-enterprise banking/thrift system. Although applicants are largely required to satisfy criteria under each of the seven statutory factors, in a newly organized institution the FDIC views management and capital adequacy as the most important. The FDIC believes active competition between banks, thrifts and other financial institutions, when conducted within applicable law and in a safe and sound manner, is in the public interest.

Examiner's Responsibility

Whether the applicant is a proposed or newly organized institution or an existing institution, a formal application for deposit insurance coverage must be filed with the FDIC. A copy of the formal application will be made available to an examiner for use in the investigation. Although the application contains data on each of the seven factors enumerated under Section 6 of the Act, reports of investigation are not to be limited to material supplied by the applicant. Reports should be factual as to necessary information and represent the independent and unbiased findings of the examiner. The examiner should in no way indicate to an applicant the probable nature of his recommendations or discuss the applicant's chance of gaining admission to the insurance system unless specifically authorized to do so by the Regional Director. Considerable reliance is placed upon impartial reports by examiners in connection with admission procedures.

The report should detail the relevant facts and data pertinent to each of the seven statutory factors, and under a separate topical heading, an opinion as to whether the FDIC's criteria under each of the statutory factors have been met. A negative opinion on one or more of the statutory factors must be fully explained and supported and, where possible, it should be indicated whether and how the situation may be corrected. The report should also include a general recommendation relative to admission and, if appropriate, a list of conditions which should be imposed. As a rule, the FDIC requires applicants to satisfy all criteria under each of the seven statutory factors. In some cases, however, minor deficiencies in certain factors may be excused when they are more than balanced by conspicuous merits in others.

The admission criteria of the FDIC and the preparation of reports by field examiners as relates to each of the seven factors enumerated in Section 6 are discussed below. The FDIC's admission criteria for proposed or newly organized institutions and existing institutions are generally the same; however, pertinent aspects specifically applicable to admission of existing institutions are covered later in this Section.

Statutory Factors, Proposed or Newly Organized Institutions

Financial History and Condition - Proposed and newly organized institutions have no financial history to serve as a basis for determining qualification for deposit insurance. Some consideration may be given to the history of other institutions presently and formerly operating in the area of the applicant, if pertinent. Except to the extent that the management of the applicant has been associated with other financial institutions and its record in that connection is considered under the management factor, the financial history factor in connection with a new enterprise should not usually receive great emphasis. Past institution failures in a community should not be a prominent consideration in acting upon the application of a new institution. New institution applications are to be judged as far as possible upon their own merits relative to capital, management, and the other factors enumerated in Section 6 of the Act.

The investigation report should include a pro forma statement of the proposed institution as of the beginning of business, and a schedule and appraisal of all assets with which the proposed institution intends to begin business.

Fixed assets are of primary concern in analyzing the asset condition of a proposed or newly organized financial institution. These assets should be listed and described in detail. For example, the following elements are pertinent to an adequate description and evaluation of applicant's realty interests: the original cost of the premises at time of construction with a breakdown between land and building, original cost to applicant, date of construction, reasonableness of purchase price, from whom purchased, insurance to be carried, assessed value, prospective or immediate repairs or alterations, estimated useful life of the building as of the beginning of business, outstanding liens, tax status, completeness of title papers, desirability of the location, and prospective annual income and expenses if the building is to be other than a one-purpose structure. Ample information should also be reported on the furniture and fixtures investment. Thereafter, the relationship between the applicant's total investment in fixed assets and capital structure should receive comment.

If the leasing of premises is contemplated either through a real estate subsidiary of the proposed institution or otherwise, the terms of the lease are to be outlined in some detail, including a description and estimated cost of any leasehold improvements. In such cases, the lease agreement should contain a termination clause, acceptable to the FDIC.

Any financial arrangement or transaction involving the applicant, its organizers, directors, officers, 5% or more shareholders, or their associates (insiders) should be avoided. If there are any such arrangements or transactions, it must be determined that they are fair and on substantially the same terms as those prevailing at the time for comparable transactions with noninsiders and must not involve more than normal risk or present unfavorable features. Full disclosure of any arrangements with insiders must be made to all proposed directors and prospective shareholders.

An evaluation and comment should be made as to whether the new institution will provide procedures, security devices, and safeguards

which will at least be equivalent to the minimum requirements of the Bank Protection Act of 1968 and Part 326 of the Rules and Regulations of the FDIC. In addition, if the new institution plans to utilize electronic data processing services for some or all of its accounting functions, proponents should be apprised of the need to furnish notification in the form prescribed in Part 304.

In applications anticipating the use of temporary quarters pending construction or renovation of permanent facilities, details should be provided regarding the location of the site in relation to the permanent location, the exact address, the rental arrangement, the leasehold improvements, and estimated nonrecoverable costs upon abandonment.

Applicants often employ professional assistance, such as attorneys, economic researchers, and other specialists to assist in the preparation and filing of an application for deposit insurance coverage. A revised policy statement adopted by the Board of Directors of the FDIC on October 25, 1977, as amended September 8, 1980, requires that legal fees and all other organizational expenses be fully accountable, identified as to source, and receive comment as to reasonableness. The FDIC requires full disclosure to all directors and shareholders of any fee in excess of $5,000 paid to insiders or their interests.

Adequacy of the Capital Structure - Under this statutory factor, a proposed or newly organized institution should have: (1) A minimum capital structure of $1,000,000 at organization unless unusual circumstances dictate otherwise; applications offering less than this sum are not encouraged; and (2) An initial capitalization to provide a ratio of equity capital and reserves to total estimated assets of at least 10% at the end of the third year of operation.

The adequacy of the capital structure of a newly organized financial institution is closely related to its deposit volume, fixed asset investment, and the anticipated future growth in deposit liabilities. In most cases, the first three years of operation is a reasonable time frame for measuring deposit growth in newly organized institutions. Accordingly, in assessing the adequacy of initial capital as related to prospective deposit volume, the examiner should develop a reasonable estimate of the deposit volume a new financial institution may generate in each of the first three years of operation, which may differ considerably from the estimates provided in the proponents' application, feasibility study, or economic survey. It is not unusual to find that the proponents' deposit projections and feasibility study are influenced by the proposed capital structure. The proponents' deposit projections may also be out-of-date or not fully supportable due to lack of adequate information and documentation. The best sources of information to assist in formulating reasonable estimates are local economic indicators, population data, deposit and loan growth in other financial institutions in the area, comments and observations of depository institution managers in the area, the competitive impact of other financial institutions, and the ability of the proponents to generate business in the trade area. In the final analysis, the estimated deposit volume for a new institution's third year of operation is highly significant because it serves the dual purpose of measuring earnings capability as well as capital adequacy after projecting a reasonable operating period.

The number of shares of stock and its par value as of the commencement of business should be scheduled. The per share price of the stock should be stated, and, in cases where an additional amount per share is assessed to cover organizational and preopening expenses, that amount should also be identified. The components of the beginning capital structure can then be allocated to capital stock, surplus, other segregations, and the organizational expense fund. It should be ascertained whether or not the State or Office of Thrift Supervision statutory minimum capital requirements are met and how evidence will be provided to the FDIC that capital funds are fully paid in prior to opening for business. If it appears the proposed capital structure will not meet the FDIC's criteria, the investigation report should reflect fully the extent of and reasons for the inadequacy and recommend to the FDIC an amount which would be acceptable. Should the attitude of the proponents be receptive to a request for supplying additional capital, it should be so indicated.

Future Earnings Prospects - Allowing a new institution to commence operations without some indication that it can be operated profitably not only creates a potentially unsatisfactory situation, but could also have a detrimental effect on other

competing financial institutions. Usually the operations of a new institution are not profitable for at least the first year. Estimates of operating income and expenses for the first three years of operation should be made using, among other things, the projections of loan and deposit volume made in connection with the "Adequacy of the Capital Structure" factor.

In determining future earnings prospects, the probable income from loans and discounts, bonds and securities, service charges and commissions, and other sources of income must be estimated. Assistance in this task may be obtained from evaluating the applicant's projections, the demand for loans in the area and types thereof, the probable nature of the institution's investment policy, the amount of time and demand deposits likely to be acquired, the probable competitive reaction from existing depository institutions, the economic conditions in the community, the possibility of future development or retrogression in the area, the apparent moneymaking ability of the institution's management, and the FDIC's statistical data for depository institutions operating in the same general area. In addition, estimates must be made for expenses such as salaries and other employee benefits, interest, occupancy and equipment outlays, electronic data processing service costs, and other current operating expenses. Assistance in making these projections may generally be obtained from the same sources used in projecting the various income categories. A review and comparison of original projections and actual data for other recently organized operating financial institutions in the same or comparable areas may be of assistance in projecting earnings and expense data.

The report of investigation should pinpoint any marked divergence between the examiner's findings and those presented in the application and the reasons for such variances. Comment should also be made on the proponents' plans for payment of cash dividends, bonuses, directors' fees, retainer fees, etc., and the accounting system to be used. It is considered imprudent to pay dividends or bonuses during the formative years of operation unless they are fully earned and justified. As regards accounting systems, the FDIC requires use of the accrual method from the outset of operations.

As indicated previously, this portion of the investigation report is, by reason of Part 303 of the FDIC's Rules and Regulations, available for public inspection.

General Character of the Management - The quality of an institution's management is vital and perhaps the single most important element in determining the applicant's acceptability for deposit insurance. To satisfy the FDIC's criteria under this factor, the evidence must support a management rating which in an operating institution would be tantamount to a rating of "2" or better. In most instances, the management of a proposed or newly organized institution will not have an operating record as a functioning unit to assist in forming a judgment; therefore, management rating essentially becomes a question of directly evaluating the individual directors and officers and then making a composite overall rating premised upon the individual analyses. The report of investigation should, therefore, contain a schedule giving the name, address, approximate age, total liabilities and net worth of each director and officer, and include with respect to each, the following information:

Comments should detail present occupation or profession and past banking, thrift, business, farming, or other experience; including observations as to how successful the individuals have been in their present and past activities and whether they have been asked to resign from a position or positions held or have been associated with serious business failures or debt compromises. As a rule of thumb, success of the majority of an applicant's management in their present business endeavors is some evidence of their ability to manage successfully the affairs of the proposed institution.

In addition, all firms, companies, corporations, and organizations in which a given director or officer is substantially interested should be indicated. If the facts denote that the institution is being organized primarily to finance the businesses or personal interests of certain officers and directors, particularly when the assets related thereto are likely to be of dubious quality, the relevant facts should be fully covered.

Duties and responsibilities as well as the title of each proposed officer and director should be outlined. If the proposed duties and responsibilities are regarded as beyond the

capabilities of a particular officer or some other distribution of duties and responsibilities among officers would be more effective than that contemplated, the opinions and reasons therefore should be indicated.

Net worth figures on each director and officer will be available from financial reports filed with the application. In listing net worth figures in the report of investigation, an opinion as to the validity of the figures and any pertinent information relating to sizable liabilities may be made.

Stock holdings of each director and officer are to be indicated. Successful operation of a financial institution requires a real interest in its welfare as well as a willingness to devote a substantial amount of time to its affairs. When directors and officers have a significant financial investment, genuine and continuing interest is more likely.

Section 19 of the Act provides that, "Except with the written consent of the FDIC, no person shall serve as a director, officer, or employee of an insured depository institution who has been convicted or who is hereafter convicted, of any criminal offense involving dishonesty or a breach of trust . . ." If it is found that criminal proceedings have at any time been instituted or fidelity insurance canceled with respect to any officer or director, or if there is any doubt concerning the integrity of any director or officer, a thorough investigation of all surrounding circumstances should be conducted. If the facts dictate, it may be appropriate that an application be filed pursuant to Section 19 of the FDI Act.

Length of residence in the community or trade area of the proposed institution and degree of familiarity with the major activities of the locale should be indicated with respect to each director and officer.

The above information should be particularly complete with respect to individuals who are likely to dominate the policies and operations of the institution. In addition, comparable information should be included on any shareholder (other than a proposed director or officer) who is subscribing to 5% or more of the aggregate par value of stock to be issued. Examiners should also include in their report any information that may come to their attention concerning possible changes that may be made in the institution's management after commencement of operations. In addition, the FDIC has found that on occasion, subsequent to approval of an application for deposit insurance and prior to the actual opening of a proposed new institution, changes have occurred in the management or ownership. In order to monitor such changes, the FDIC requires that the prospective incorporators advise the Regional Director in writing if changes in the directorate, active management, or in the ownership of stock of 5% or more of the total are made prior to opening. When conducting investigations, this notification should be stressed in any discussions with the proponents.

Certain other information relative to the sale and purchase of the proposed institution's stock and the exercise of voting rights may also reflect on the general quality and character of management. While these matters may also relate to the "Adequacy of Capital Structure" factor, on balance they are more appropriately treated herein. It should be determined whether any commissions are to be paid in connection with the sale of the stock and confirmed that no loans representing applicant stock purchases will be refinanced by the institution. Any evidence that the institution is being organized on a promotional basis should also be covered. Ownership control by several individuals or groups of shareholders as well as any contemplated or existing buy-sell, voting trust, or proxy agreements between various individuals or other entities, such as holding companies, should also receive comment and copies of any such agreements obtained from the applicant or proponents involved. A list of stock subscribers as of the date of investigation should be obtained including therein at least the following: the number of shares per individual subscriber of 5% or more of the total stock issue, all proposed directors and officers, the par value and the purchase price of the stock, and any financing arrangement including the source of financing and the collateral pledged on the loans. It is expected that detailed comments would be made on any unsound financing arrangements, such as individual servicing ability and preferential rates particularly related to compensating balances and other abuses. Ordinarily, financing of more than 75% of the purchase price of stock subscribed by any one individual, or aggregate financing of stock subscriptions in excess of 50% of the total capital offered, is presumed to be excessive and

may result in denial of the application under this statutory factor, unless support and justification for exceeding these guidelines as furnished are acceptable to the FDIC.

Proponents should be made aware of the prohibition against interlocking management relations applicable to depository institutions (banks, savings and loan associations, mutual savings banks, and credit unions) and depository holding companies (banks and savings and loan holding companies) contained in Title 11 of FIRIRCA and Part 348 of the FDIC's Rules and Regulations.

The FDIC adheres to a fixed policy requiring that all applicants provide at least a five member board of directors, even though the State law may, in some cases, permit a lesser number.

On the basis of the facts and considerations detailed in the report of investigation, examiners should state, and factually support to the greatest extent possible, their conclusions as to the management rating.

A notation as to the type and amount of the insurance (fidelity, burglary, robbery, etc.) to be carried by the institution should be included in the report under the management heading. With respect to fidelity coverage, the FDIC's position is that applicants should subscribe to and maintain adequate coverage and have in force at all times a $1 million excess bank employee dishonesty bond, if primary blanket bond coverage is less than $1 million.

An applicant bank or an applicant branch of a foreign bank that expects to operate an international loan department or conduct international lending and investment activities is expected to address country risk and related concentrations of credit with respect to these activities in their written policies. These factors should be segregated from other lending and investment risk criteria and addressed separately in the policies. Policy coverage should not be limited to just loans, but should also encompass securities, deposit balances, acceptances, and other activities that are expected to be included in the bank's or branch's operations. If an applicant does not intend to engage in such activity, they should specifically so state.

Risk Presented to the Insurance Fund - This factor is to be broadly interpreted and may be the most relevant in the unusual circumstance where none of the other factors is clearly identifiable as unfavorable. For example, "risk to the fund" might be resolved unfavorably and the application denied based on the applicant's unsound business plan even though all the other factors might be favorably resolved. Like a recommendation based on any other factor, an unfavorable finding based on "risk to the fund" must be clearly articulated.

Convenience and Needs of the Community to be Served - Generally, there is a presumptive indication of need if the directors or organizers of the applicant are a responsible group of persons willing and able to supply a substantial and adequate amount of money to back up their judgment, and if the management of the proposed institution is competent, honest and familiar with the problems of the area to be served. However, consideration should be given to the adequacy of existing depository institution facilities in the community and in nearby rival communities, for a financial institution is unlikely to fulfill a need if it is unable to command sufficient volume to maintain profitable operations. In this connection, the Examiner should endeavor to ascertain whether or not the services rendered by existing depository institutions are satisfactory, and whether or not such institutions are meeting the legitimate credit needs of the community.

It should be noted that the provisions of the Community Reinvestment Act are especially relevant in evaluating this statutory factor. Considerations required by the National Historic Preservation Act and the National Environmental Policy Act of 1969 must also be favorably resolved and the applicant is generally requested to submit data in this regard for evaluation.

In considering the question of need, it is important that the examiner not adopt the viewpoint of depository institutions located in the community, to the exclusion of other, equally persuasive viewpoints. As in the other lines of business, existing financial institutions may regard any new institutions as unnecessary and a potentially "harmful competitor". An unbiased conclusion in this connection requires impartial consideration of the opinions of the organizers of the applicant as well as those of the management of existing institutions. In addition, it is sometimes necessary to solicit the views of

representative business and professional persons in the community, together with those of citizens of more modest means. The results of canvasses and surveys of local individual or business persons should be set forth in the report in order to assist in evaluating support for the proposed institution, the adequacy of present depository institution facilities, whether the legitimate banking needs of the community are being met, whether and to what extent the new facility would be used, and the knowledge these persons have of the proponents. In the final analysis, the value of any information so obtained will depend largely on the examiner's ability to discriminate between those views which proceed from intelligent and rational consideration of the real needs of the community and those which are mainly inspired by a false sense of community pride or selfish personal interest.

A clear definition of the proposed institution's trade area is essential in determining convenience and needs. A brief description of the general area in which the proposed institution is to be situated and its location in relation to other prominent nearby communities, developments, or other important landmarks should be initially presented. The primary trade area as described in the application should then be discussed along with an opinion as to the validity of the applicant's definition of the trade area. In some instances, the applicant may artificially draw its trade area boundaries so as to exclude factors which would be unfavorable to the proposal (nearby depository institutions, depressed areas, etc.) and include others which would increase the attractiveness of the proposed location (significant residential or commercial developments, highly concentrated population area, etc.). Any differences between the examiner's conception of the trade area and that of the proponents should be discussed fully in the report together with a description of the trade area as the examiner perceives it. Once the trade area has been defined, information regarding the following should be set forth.

The principal industrial, trade, or agricultural activity should be described and, if considered relevant, annual values of principal products indicated. The presence and source of large payrolls in the area may also be an important consideration. The past and present volume of postal activity and the number and value of residential and commercial building permits can often be of considerable value in determining the vitality of the area. Figures regarding retail sales from public sources or trade organizations are useful; however, if they are not available, it may be possible to obtain some estimates of volume in the course of conducting a survey of the locale's business establishments. Information regarding medical facilities and other professional services can be a useful indicator of the self- sufficiency of the community or trade area. Statistical information on governmental units such as; assessed valuations, tax levies, bonded indebtedness, and tax delinquencies, and data on the educational environment of the area are also valuable indicators. Reports of investigation should not, however, be filled with pages of statistics unless the figures are relevant.

Population figures within the trade area as well as the general surrounding areas are significant determinants in considering convenience and needs. While population as of the date of investigation is important, data which establishes population trends as well as projections for the future should be presented. In some cases it is difficult to obtain accurate population data for a particular trade area, as statistics combine portions of several census tracts. In some instances, data showing the number of household units in the area may be a more appropriate basis for assessing reasonable population estimates.

The examiner should include a schedule of all banking and thrift offices likely to be affected by the proposed institution, including the name, location, and year established, total deposits, and the distance and direction from the proposed office site. Current directories, statistical surveys and summaries prepared by the FDIC, and recent call reports are primary sources of information for this schedule. Officials of area depository institutions should be contacted during the investigation and given an opportunity to express their attitudes on the proposal. Any formal objections to the proposal should be investigated and comments relative to discussions with the objector(s) set forth in the investigation report. The probable competitive effects of a new institution proposal should be fully weighed by the examiner. While the number of depository institutions operating in the city or area to be served is important in determining whether the addition of a new institution may result in an overbanked condition, consideration should also be given to possible procompetitive consequences flowing from the new institution

proposal, such as increased customer services and banking options to residents of the area. Therefore, it is necessary to furnish complete factual data with respect to the probable impact of the proposal on existing financial institutions in the community.

The extent of new or proposed residential, commercial and industrial development and construction is a significant secondary consideration in resolving the convenience and needs factor. Plans for the development of shopping centers, apartment complexes and other residential subdivisions, factories, or other major facilities near the proposed site should, therefore, receive comment. In certain instances, inclusion of maps may be desirable to clarify comments, showing location of competing depository institutions or branches, important buildings, offices, shopping centers, industrial parks, and the like in relation to the office site. As in the case of the "Future Earnings Prospects' factor, this portion of the investigation report is also available for public inspection under Part 303 of the FDIC's Rules and Regulations.

Consistency of Corporate Powers - Nonbanking powers and certain activities of savings associations, other than trust powers, are regarded by the FDIC as inconsistent with the purpose of the Act, and the FDIC's policies under this statutory factor have been established accordingly. For example, Part 332 of the FDIC's Rules and Regulations prohibits the exercise of certain specific powers which are inconsistent with the purposes of the Act, including, among others, guaranteeing or acting as surety for the obligations of others and insuring, guaranteeing or certifying real estate titles. Since the applicant will have agreed in its application not to exercise nonbanking powers whether granted by charter or statute, the examiner need only refer to this previously obtained agreement. Additional comments may be included if the terms of the agreement are not generally understood by the applicant or if they regard the agreement as being incomplete or amendment to the Articles of Association or Charter is necessary or desirable. Part 313 of the FDIC's Rules and Regulations addresses activities of savings associations.

Miscellaneous - The existence of any conflicting applications to establish depository facilities in the immediate area should be indicated and receive appropriate comment in the examiner's report of investigation. If operation of a trust department is contemplated, applicant must also file with the FDIC the appropriate form covering "Application for Consent to Exercise Trust Powers". This form will provide much of the information necessary for the completion of the report of investigation with respect to this phase of the applicant's operations. If the proposed trust functions will materially affect the examiner's findings in making a recommendation on anyone of the seven factors contained in Section 6 of the Federal Deposit Insurance Act, it may be advisable to analyze the prospects for the operation of the commercial and trust departments under separate subheadings for any factor so affected.

The examiner should indicate, if ascertainable, the number of tellers' windows at which insured deposits will be received.

If any of the documents essential for full consideration of the application have not been submitted to the FDIC, the proponents should be instructed to transmit such documents at the earliest practical date and a notation to that effect included in the report.

Statutory Factors, Existing Institutions

As indicated previously, the FDIC's admission criteria for proposed or newly organized institutions and for existing institutions are generally the same. Consequently, principles previously discussed in this section of the Manual are not repeated herein. Prior to processing applications for existing institutions for deposit insurance coverage, examiners should familiarize themselves not only with the following provisions but also those set forth under "Statutory Factors, Proposed or Newly Organized Institutions". In the case of an existing institution, the FDIC will conduct an examination of the ongoing institution or its predecessor institution and a report prepared on the regular printed FDIC form, with appropriate notation on the cover indicating the special purpose of the examination. Under Examiner's Comments and Conclusions of the Supervisory Section of the examination report, the examiner is required to discuss separately each of the seven statutory factors.

Financial History and Condition - While the financial history of an operating institution is usually reflected in its present condition, the basic cause or causes for an institution's

condition, whether satisfactory or unsatisfactory, should be analyzed and the reasons therefor ascertained. Accordingly, where the financial history of an operating institution has not been successful or is questionable, the FDIC generally requires reasonable assurance that the cause or causes of any past difficulties of a serious nature have in large measure either been overcome or ceased to exist.

Date of primary organization should be indicated. Another important feature in the financial history of an existing institution is its past attitude on the prompt recognition and current charge-off of losses and the administration of dividend policies. In addition, mergers, consolidations, recapitalizations, reorganizations, liability assumptions, deposit waivers, deposit deferments, and similar events which are not recent should be covered in the examination report, but in less detail.

With respect to an operating institution's financial condition, the FDIC customarily requires that the general quality of its net assets be satisfactory and on a par with that of peer institutions. In appraising the value and quality of an applicant operating institution's assets, the same appraisal and classification procedures and criteria are to be followed as in regular FDIC examinations. The "Summary of Assets Subject to Adverse Classification or Special Mention" set forth in the report of examination as well as the "Summary Analysis of Examination Reports" (formerly Form 96) should include data on the quality of an institution's net assets. This information should be summarized in the Examiner's Comments and Conclusions of the Supervisory Section under an appropriate caption. General comments on asset condition and problems should also be included, as well as a summary of "Violations of Laws and Regulations", contingent liabilities, existing litigation against the institution, dividend and remuneration policies, and other matters which could affect the institution's condition.

Adequacy of the Capital Structure - An existing institution applying for deposit insurance should have sufficient capital to support the volume, type, and character of its business, provide for losses, and meet the reasonable credit needs of the community which it serves. The process of determining the adequacy of an institution's existing capital as well as that after three years of operation (considering estimated deposit growth) begins with a qualitative evaluation of critical variables that directly bear on the institution's overall financial condition. These variables as well as all the principles set forth in the FDIC Statement of Policy on Capital (refer to the Capital Section of this Manual), are applicable here. The Statement, setting forth various levels for adjusted equity capital, only provides a benchmark for evaluating capital adequacy. Although it establishes uniform standards for capital levels among depository institutions regardless of size, the ratios set forth therein are, however, only starting points since such ratios are not in themselves determinative and must be integrated with all other relevant factors such as character of management, quality of assets, and so on. In the final analysis, each case must be judged on its own merits. It should be recognized that various State banking departments may impose more stringent capital requirements than those set forth in the FDIC Statement of Policy on Capital.

The examination report should include some of the data necessary for determining whether the applicant's capital is adequate. These data should also be summarized and augmented in the Examiner's Conclusions and Recommendations of the Supervisory Section under the caption "Adequacy of Capital Structure". If for any reason a substantial increase in deposits is anticipated, or any plans of the applicant with respect to the institution's capital structure are contemplated, or if the proponents appear receptive to a request for supplying additional capital, it should be so indicated in the examination report. It is desirable to include under this caption, or as a supplemental page to the examination report, a complete or reasonably complete list of all shareholders, their holdings, and related interests.

Future Earnings Prospects - The earnings capability of an existing institution is reflected in its earnings record. Ordinarily, an operating institution's earnings record should indicate ability to pay all operating expenses with a safe margin for the absorption of losses and for the payment of reasonable dividends. For comparative purposes, current earnings ratios may be obtained from various data prepared by the FDIC. If earnings have not been sufficient, areas where income may be improved or expenses reduced should be noted. The principles described in the Earnings Section of this Manual are applicable here. The income and expense

figures reflected in the examination report are book figures. If the examiner regards these figures as incorrect or misleading because of improper accounting for unearned discounts, failure to charge off losses, failure to properly depreciate fixed assets, or similar deviations from accepted practices, the matter should be fully discussed in the presentation of earnings data in the Supervisory Section. The examiner should also comment on the effect deposit insurance coverage might have on the institution's income and expenses in the future.

General Character of Management - In the case of an existing institution, management may be evaluated both from the standpoint of the institution's condition and the vantage point of management's past performance as reflected in the books and records of the institution, previous examination reports of and correspondence from other regulators, and internal records, such as committee and board of directors' minutes. A management rating of "2" or better is necessary to satisfy the requirements of this statutory factor. The rating of management is discussed in the Management Supervision, Administration and Control Section of this Manual.

Complete information on management will be included in the report. In addition, a summary discussion of important aspects of this information, together with information on director and officer indebtedness to the institution, should be included under this caption in the "Examiner's Conclusions and Recommendations" of the Supervisory Section. If management is not regarded as warranting a rating of "2" or better, it should be indicated what changes are believed essential to warrant such a rating.

Fidelity insurance on active officers and employees and other indemnity protection should receive comment to the extent necessary under this captioned statutory factor.

Risk Presented to the Insurance Fund - Analysis of this factor is the same as previously described for proposed new institutions.

Convenience and Needs of the Community - The FDIC's criteria under this statutory factor are closely related to those outlined with respect to the "Future Earnings Prospects" factor. A going institution which is being successfully and profitably operated, and which has a recognized place and established customer relationships in its community, is for self-evident reasons convenient to and fulfilling the needs of the community it serves. An institution may, however, have had inferior earnings in the past and nevertheless qualify under this statutory factor. Any pertinent information with respect to local economic conditions, population trends, or unusual circumstances which have affected or may affect the community and the applicant should be commented on under this caption.

It should be noted that the provisions of the Community Reinvestment Act are relevant in evaluating this statutory factor.

Consistency of Corporate Powers - Nonbanking powers and certain saving associations activities, other than trust powers, are regarded by the FDIC as inconsistent with the purposes of the Act. In some states, institutions have been granted the right under their charters or by statute to engage in certain nonbanking activities. The right to guarantee titles to real estate, to guarantee mortgages and mortgage participation certificates, and to issue various forms of insurance are examples of such nonbanking powers. Many institutions, however, which possess such powers do not exercise them.

The examination report should indicate the character of any nonbanking powers which an applicant institution possesses, whether or not exercised. It should also contain a full discussion of the extent of an institution's nonbanking business and the nature and amount of any liabilities resulting therefrom. In addition, examination reports should include a discussion of any nonbanking activities which are ultra vires or beyond the charter, corporate, or statutory powers granted. It is desirable, however, that this information be summarized in the "Examiner's Conclusions and Recommendations" of the Supervisory Section under "Consistency of Corporate Powers".

The FDIC as a rule obtains an agreement from an applicant in the formal application not to exercise nonbanking powers after deposit insurance has been granted. Nonetheless, it is desirable to know the extent to which the institution has engaged in nonbanking activities in the past, and the extent to which its past income was dependent upon such activities. Moreover, examiners may feel that the agreement

incorporated in the application is not sufficiently complete and that additional agreements or amendments to the Articles of Association or Charter are necessary, in which event they should so state in their reports. Part 313 of the FDIC's Rules and Regulations addresses activities for savings associations.

Miscellaneous - If the applicant operates a trust department, an examination will be conducted and a report of examination compiled. The examiner should consider the condition and the prospects of the trust department in developing the conclusion for each factor enumerated under Section 6 of the Act. Should trust department operations be of sufficient influence in the final determination of the examiner's findings on any of the factors, it may be advisable to analyze the commercial and the trust operations under appropriate subheadings.

The examiner should indicate the number of tellers' windows at which insured deposits will be received.

If any of the documents essential for full consideration of the application have not been submitted to the FDIC, the proponents should be instructed to transmit such documents at the earliest practical date and a notation to that effect included in the report.

Examiners should indicate in their reports the sources of information on significant points covered in their comments. During the examination, the examiner should review reports of examination of other supervisory authorities and correspondence from these authorities.

II. APPLICATIONS TO ESTABLISH A BRANCH OR TO MOVE MAIN OFFICE OR BRANCH

Provisions of Law

Under the provisions of Section 18(d) of the Federal Deposit Insurance Act (the "Act"), no State nonmember insured bank may establish and operate any new branch, or change the location of any existing branch, or move its main office, unless it obtains the prior written consent of the FDIC. The factors to be considered in granting or withholding such consent are those enumerated in Section 6 of the Act. Various sections of Part 303 of the FDIC's Rules and Regulations govern in large measure the administrative handling of applications to establish a branch or to relocate an office. As in the case of applications for deposit insurance, of significance is the provision which allows public access to the nonconfidential portions of each application file to establish a branch or relocate an office which must include, among other things, the future earnings prospects and convenience and needs portions of the investigation report.

Changing Location Versus Establishing a Branch

As a general rule, an application involving a move of an existing office from one location to another within the same primary market area is of less significance from the FDIC's point of view than a relocation to a different primary market area or the establishment of a new branch. In most instances, a relocation application will not involve an examination of the bank or a field investigation of the proposal and will be handled entirely by the Regional Office under delegated authority. Consequently, some modifications of the FDIC's guidelines are frequently warranted in considering relocations as opposed to establishing de novo branches. For example, there could be some deficiency in management or capital which could likely be cause for denial of a de novo branch application, but because of the lesser degree of significance in the relocation proposal, a favorable finding could be accorded. Circumstances will govern in particular cases.

Branch Procedure

The responsibilities of the FDIC, as well as the rights of both applicants and the FDIC, with respect to branch applications are comparable in character to those arising under applicable law in applications for deposit insurance. For this reason, it is appropriate that the procedure followed in applications for deposit insurance be adhered to insofar as practical in dealing with branch applications. The instructions previously incorporated in the Manual relative to "Applications for Deposit Insurance" are, therefore, general guidelines for the preparation of reports on branch applications.

In applying to establish a branch or to relocate an existing office, State nonmember insured banks must file an application in letter form with the

FDIC. Preliminary consideration will be given in the Regional Office to applications to determine whether an examination of the applicant bank should be ordered. In all cases, however, either a field or regional office investigation of these proposals will be made. A field examiner, if assigned, will be provided with a copy of the formal application filed and the latest Report of Examination of the bank to expedite completion of the investigation report.

Recommendations by Examiners

As in the case of applications for deposit insurance, in reports on branch applications, after presenting the data and facts on each of the seven factors enumerated under Section 6 of the Act, the Examiner should set forth an opinion in summary form under "Conclusions and Recommendations" as to whether the FDIC's guidelines under each of the statutory factors have been met. If the criteria under certain factors are not met, the matter should be treated more fully and an indication made whether correction of the situation is possible. The report should also include a general recommendation relative to application, as well as a list of conditions which should be imposed. As a rule, the FDIC requires that applicants meet all guidelines applicable to each of the seven statutory factors. In some cases, however, minor deficiencies in certain factors may be set aside when they are more than balanced by conspicuous merits in others.

Factors Under Section 6 - De Novo Branches or Relocations

Financial History and Condition - In general, the guidelines outlined under this factor for existing institutions applying for deposit insurance are applicable to branch applications. For evident reasons, the risk to the FDIC in a branch system must be measured in terms of the whole and not in terms of a part. Consequently, emphasis should be placed upon the financial history and condition of the applicant bank, rather than upon the financial history and condition of the subject branch. Current balance sheet data of the applicant bank, an analysis of the capital account, earnings data over the past three- year period, and the trend of deposits over the last five calendar years, should be reflected on the appropriate pages of the report of investigation.

If the proposal involves the purchase or construction of additional bank premises or other fixed assets, detailed comments are necessary. If the premises are to be leased, detailed information as to the terms of the lease should be included, as well as a detailed description and estimate of cost of any leasehold improvements. The resulting total fixed asset investment, together with any uncapitalized fixed asset investment for previously approved and/or pending branch or relocation applications, should be related to capital funds and comment made regarding conformance with FDIC guidelines and applicable State laws. It is expected that any transactions connected with the proposed application which involve the applicant's directors, officers, or shareholders who directly or indirectly control 5% or more of any class of the bank's outstanding voting stock, or their interests, will be fair and reasonable in comparison to similar arrangements that could have been made with independent third parties. Full details of all transactions with such parties or their interests should be included.

Adequacy of Capital Structure - Adequacy of capital structure should be considered in terms of the applicant bank and all of its branches. Exceptions from this approach are permissible in situations where the overall capital adequacy of a bank will be furthered by the bank's proposal even though the proposed injection of new capital may fall short of bringing the capital structure to the desired level. Where the establishment of a branch or the relocation of an existing office is likely to lead to an expansion in the deposits and assets of the applicant bank, the situation should be considered on the basis of such possible increase. Management plans or commitments to bring capital up to FDIC guidelines are to be fully covered. Capital adjustments necessary because of State law requirements applicable to the establishment of a branch or relocation of an existing office should likewise be treated in the report of investigation.

Future Earnings Prospects - Future earnings prospects should be considered in terms of both the applicant bank as a whole, as discussed under this factor for existing institutions applying for deposit insurance, and in terms of the particular subject branch. Applications in connection with the establishment of de novo branches include the applicant's estimates of total deposits, average deposits, income and expense projections, and net profits for the branch for

each of the first three years of operation. Examiners must make the same estimates based upon their findings and should comment upon any marked divergence between their views and those of the applicant as well as the reasonableness of the projections contained in the application. The earnings and profits of the applicant bank should be in sufficient amount so that in the event the subject branch does not prove as profitable as anticipated, any operating deficit resulting from its operation will not prove embarrassing. In relation to a proposed branch or relocation, particular attention should be devoted to additional fixed or overhead expenses for salaries, taxes, and depreciation and other charges related to fixed assets.

This portion of the investigation report is, by reason of Part 303 of the FDIC's Rules and Regulations, available for public inspection.

General Character of the Management - Management must be considered in terms of both the applicant as a whole and the subject branch alone. For a favorable finding, the management of the applicant bank should merit a rating of "3" or better. Additionally, the management of the subject branch should be treated fully as to qualifications and experience, especially if new personnel not previously associated with the applicant bank are to be employed or if the proposed branch is likely to attain substantial size. Comment should also be made upon any recent changes in the applicant bank's directors or principal officers since the last FDIC examination. Lending or other authority to be exercised by branch officials, supervision to be maintained over branch activities by the main office, and information with respect to audits or examinations to be conducted should be indicated. Data on fidelity coverage of branch officials and employees should also be included, and the examiner should determine whether the applicant bank has or will obtain the $1 million excess employee dishonesty bond, if primary blanket bond coverage is less than $1 million.

Risk Presented to the Insurance Fund - Analysis of this factor is the same as previously described for new institutions.

Convenience and Needs of the Community - Where the application is to establish a new branch, the guidelines and considerations outlined under this factor for applications for deposit insurance by proposed or newly organized institutions apply insofar as pertinent. Where the application is to relocate an existing office, particularly in the same community, the guidelines set forth under this factor for applications for deposit insurance by existing institutions will as a rule have greater relevancy.

As in the case of applications for deposit insurance, the provisions of the Community Reinvestment Act, the National Historic Preservation Act, and the National Environmental Policy Act of 1969, must be favorably resolved.

The competitive factor is of primary importance in preparing the report of investigation for new branches. Existing competition within the proposed trade area, including a schedule of competing depository institutions (and their nearby branches), listing, as a minimum, their respective deposit and loan totals and distance from the proposed subject branch location should be fully evaluated. In large centers of population, the requirement for listing all depository institutions within 25 miles may be disregarded, and the listing confined to depository institutions or branches operating within the general competitive area to be served by the proposed branch.

As in the case of the "Future Earnings Prospects" factor, this portion of the investigation report is available for public inspection by reason of Part 303 of the FDIC's Rules and Regulations.

Consistency of Corporate Powers - This factor will usually have only limited application in connection with branches. Unless the applicant bank indicates that it intends to change the nature of its business to incorporate a power which is not regarded as a usual function of the bank, a general comment to the effect that inconsistent powers are not intended to be exercised will generally suffice to make a favorable finding on this factor. The examiner's comments under this factor should in all cases touch upon the question of trust department operations and whether they are contemplated at the subject branch.

III. APPLICATIONS FOR CONSENT TO EXERCISE TRUST POWERS

Introduction

Part 333 of the FDIC's Rules and Regulations prohibits any insured State nonmember bank (hereinafter referred to as "bank") from changing the general character of the business exercised by it without the prior written consent of the FDIC. Therefore, general policy is that unless a bank is currently exercising trust powers, it must file a formal application with the FDIC on the appropriate form entitled "Application for Consent to Exercise Trust Powers" or in certain regions on the common application form in use, and must obtain the prior written consent of the FDIC before it may validly and properly exercise such powers. The FDIC does not grant trust powers but only consents to the exercise of such powers as granted or permitted by the governing State authority. The test to determine a change in character of business is left to the discretion of the FDIC but normally occurs for trust powers when a fiduciary relationship is created where none had previously existed. Various sections of Part 303 of the FDIC's Rules and Regulations largely govern the administrative handling of applications to exercise trust powers.

Administering Trust Applications

An FDIC approved "Statement of Principles of Trust Department Management" outlines minimum requirements for sound practices in the operation of a bank trust department. Before final approval of any application for consent to the exercise of trust powers may be granted, an agreement should be obtained from the management of the bank that the minimum requirements set forth in the aforementioned "Statement" will be followed. In addition, in reviewing any such application, although not required by statute, the seven statutory factors set forth in Section 6 of the Federal Deposit Insurance Act should be considered.

Normal prerequisites for the FDIC's consent to the exercise of trust powers are that, as previously stated, the bank's board of directors formally adopt the minimum requirements set forth in the above mentioned "Statement" and that the applicant bank provide sufficient staff and facilities to meet minimum standards of competency in trust matters. Applications for consent to exercise full trust powers by banks (usually smaller in size) that are not equipped management-wise to administer trust activities other than very routine matters should be closely scrutinized and, where limited powers will suffice, the bank should be encouraged to file for specified limited powers. In all cases, in order to approve any application for consent to exercise trust powers, it must be concluded that management available for contemplated trust operations is capable of handling anticipated trust business. While fiduciary duties may be exercised in conjunction with another corporate trustee, agency agreements submitted in connection with applications for consent to exercise trust powers should be reviewed to determine that the basic responsibilities of the applicant would not be transferred thereunder to a third party.

Additional Information

Whether or not additional information is necessary in order to approve or to recommend denial of an application for consent to exercise trust powers is generally left to the discretion of the Regional Director. If additional information is needed, such information may be obtained by correspondence, telephone, personal visit, or such other means or combination of means as the Regional Director deems appropriate under the circumstances. Several additional matters that may be relevant are suggested hereafter in outline form.

Competition - The location of competing banks exercising trust powers can be obtained from various data prepared by the FDIC. If the lack of adequacy of trust facilities in the area is of importance in determining a recommendation, competitive information should be secured.

Trust Business Development - The size and scope of the proposed operation may be influenced considerably in some areas by the extent to which the applicant plans to use advertising, personal solicitation and other public relations activities. Hence, the anticipated advertising program may be a factor meriting attention.

Amount and Kind of Property and Potential Volume of Business - The sources of such data will vary widely in different areas. Any information as to the wealth of the trade territory and the type of assets or property by which it is principally represented would, in some instances, prove beneficial. When feasible, review of probate court and tax records in the particular area as well as reports of governmental and other agencies can provide some valuable statistics. The three

Federal banking agencies prepared a publication entitled "Trust Assets of Insured Commercial Banks" based on information furnished annually by insured commercial banks which operate a trust department. Such publication and background statistical information may prove beneficial for such review. Discussions with local attorneys may give some indication of the type of wealth and possible volume of business.

Deposit Structure - If collateral benefits, such as the attraction of a substantial volume of new deposits in the commercial banking department, are anticipated from the establishment of trust services, full details should be provided, particularly with reference to any accounts that may approach or be in the large deposit category. Caution is suggested in allowing too much weight in the consideration for claims of collateral benefits for, if such materialize, they are oftentimes shortlived while the obligations on the trust services continue.

Fixed Assets - If the establishment of the trust department will result in an important increase in an already heavy fixed asset investment, full details should be provided.

IV. CHANGE IN BANK CONTROL ACT

Introduction

The Change in Bank Control Act of 1978, Title VI of the Financial Institutions Regulatory and Interest Rate Control Act of 1978, amended Section 7(j) of the Federal Deposit Insurance Act. The amendments gave Federal banking agencies authority to disapprove changes in control of insured banks and bank holding companies. The appropriate agencies for changes in control are: the FDIC for insured nonmember banks, The Board of Governors of the Federal Reserve System for member banks and bank holding companies, the Comptroller of the Currency for national banks, and the Director of the Office of Thrift Supervision for savings associations and savings and loan holding companies. Previous reporting requirements relating to loans by banks secured by stock of other banks and management changes occurring after a change in control were retained with some modification and these requirements were extended to bank holding companies and loans secured by bank holding company stock. The FDIC's objectives in its administration of the Change in Bank Control Act are to enhance and maintain public confidence in the banking system by preventing identifiable serious adverse effects resulting from anticompetitive combinations of interest, inadequate financial support, and unsuitable management in these institutions. The FDIC will review each notice to acquire control of an insured State nonmember bank and disapprove transactions likely to have serious harmful effects.

Provisions of Law

Section 7(j) of the FDI Act; Section 303.4 of the FDIC's Rules and Regulations and the FDIC Statement of Policy, "Changes in Control in Nonmember Banks," set forth in detail all necessary requisites and instructions.

Procedures

Any person (broadly defined) seeking to acquire control (power to vote 25% or more of any class of voting securities) of any insured bank or bank holding company, is required to provide sixty days prior written notice to the appropriate agency. A person means an individual or a corporation, partnership, trust, association, joint venture, pool, syndicate, sole proprietorship, unincorporated organization, or any other form of entity. A Notice of Acquisition of Control form is required to be filed with the appropriate Regional Office, accompanied by a completed and signed Financial Report and Biographical Information form for each of the acquiring parties to the extent known.

The FDIC reviews the information reported in a Notice to assess any anticompetitive or monopolistic effects of the proposed acquisition, to determine if the financial condition of any acquiring person is such as might jeopardize the financial stability of the bank or prejudice the interests of the depositors of the bank, and to determine whether the competence, experience, or integrity of any inquiring person, or any of the proposed management personnel, indicates that it would not be in the interest of the depositors of the bank, or in the interests of the public, to permit such person to control the bank.

While processing and handling of Notices may parallel the procedures related to applications for deposit insurance, new branches, relocations,

etc., at least one fundamental difference is present. In the case of statutory applications, the burden of making a case in support of a proposal falls on the applicant; in considering Notices, the FDIC exercises a veto, with a burden of sustaining a disapproval falling on the FDIC. Accordingly, in evaluating Notices, the FDIC need not find favorably on the various factors; the absence of unfavorable findings approximates tacit approval.

Regional Directors are delegated, with certain exceptions, authority to issue a written notice of the FDIC's intent not to disapprove an acquisition of control. Authority to disapprove has been retained by the FDIC's Board of Directors but since an acquisition may be consummated if the period of disapproval expires or the Regional Director issues a letter of intent not to disapprove, a notice proposal does not require a positive approval as would a statutory application. If written views of the State authority recommend disapproval, or if an acquiring party discloses a conviction or a plea of no contest to a criminal charge involving dishonesty or breach of trust, the Regional Director makes a recommendation to Washington based on the findings under the factors.

The factors considered in evaluating Notices and the basis for disapproval are, in brief: whether the proposed acquisition of control would result in a monopoly; whether the effect the proposed acquisition of control in any section of the country may be substantially to lessen competition or to tend to create a monopoly, or would in any other manner be in restraint of trade; the financial condition of the acquiring party and its potential impact on the financial stability of the bank or prejudice the interests of depositors; the competence, experience or integrity of any acquiring person or proposed management; if any acquiring party neglects, fails, or refuses to furnish all the information required by the FDIC; or the effect on the Bank Insurance Fund or Savings Association Insurance Fund is adverse.

A transaction triggering the notice requirements may not result in the acquiring party actually gaining effective control of an institution. For example, a person acquiring 25% of voting control would not gain effective control if there were an existing shareholder with 50% of voting control. Nonetheless, the transaction triggers the notice requirement and a Notice should be evaluated as if it were an actual change in effective control. After once complying, further acquisitions by the same person in the same bank do not require filing of notices. An acquiring party who continuously remains within the definition of control needs to file only one notice per bank to be in compliance.

Certain types of transactions are exempt from prior notice requirements, such as those subject to Section 3 of the Bank Holding Company Act, Section 10 of the Home Owner's Loan Act, or Section 18 of the FDI Act, since they are covered by existing regulatory approval procedures. Accordingly, changes in control due to acquisitions by bank holding companies and those resulting from mergers, consolidations, or other similar transactions are not covered. Acquisition of shares of foreign banks are exempt, however, foreign banks with insured domestic branches are subject to the after-the-fact reporting requirements. Transactions resulting in voting control of 10% or more of any class of voting securities of banks whose securities are subject to the regulation requirements of Part 335 of the FDIC's Rules and Regulations are presumed to be acquisitions of control as are similar transactions of unregistered banks resulting in 10% or more control whereby the acquiring party would become the largest shareholder. These latter two are rebuttable presumptions of control. In addition, the following types of transactions are also exempt: a foreclosure of a debt previously contracted in good faith; testate or intestate successions; a bona fide gift; and; a transaction described in Section 2(a)(5) or 3(a)(5)(A) or (B) of the Bank Holding Company Act by a person there described.

Persons acquiring control by exempt transactions while not required to give prior notice, are required to provide after-the-fact information on the transaction and other information regarding changes in management or policies of the bank. Personal financial and biographical information may be requested subsequent to changes in control of these types at the discretion of the Regional Director. Affected banks are required to report changes or replacement of chief executive officers or directors occurring within twelve months after change in control, including a statement of the past and current business and professional affiliations of the new chief executive officer or director.

Section 7(j) also requires the chief executive

officer of an insured bank that makes a loan secured or to be secured by 25% or more of the voting stock of another insured bank to report the facts to the appropriate regulatory agency. No report need be made where the stock is that of a newly organized bank prior to its opening. Through the definition of insured bank, the reporting requirement is extended to include loans secured by bank holding company stock.

Effective enforcement of Section 7(j) requires examiners to review stockholder ledgers and records and review correspondence files to determine whether any nonexempt stock transactions have occurred which would constitute an acquisition of control, whether prior notice has been provided to the FDIC where required, and, if bank management has complied with the after-the-fact reporting requirements relating to bank stock loan reports and changes or replacement of the chief executive or directors. Review of stockholder records must be conducted with particular attention to the statutory definition of control, including the presumptions of control established in Part 303 of the FDIC's Rules and Regulations. All substantial change in ownership transactions between examinations should be reviewed, however, a relatively small transaction may trigger the notice requirements and the statutory definition of control does not necessarily imply effective control. Examiners should also be alert to the formation of voting trusts, assignments of proxies of duration beyond the customary annual meeting solicitations, and other similar arrangements which effectively transfer voting control and which may require prior notice. The statute and implementing regulations do not elaborate on what constitutes a group acting in concert. A series of transactions which are individually insignificant, but significant when aggregated, may indicate a subterfuge, particularly if the individuals or entities involved have other business or professional relationships. Consultation with the Regional Office would appear prudent should such a situation of this type be encountered.
Apparent violations regarding acquisitions consummated without filing of a prior notice should be communicated to the Regional Office by telephone and reported in the Supervisory Section of the report of examination. Apparent violations for failure to comply with the after-the-fact reporting requirements should be detailed in the open section of the report under Violations of Laws and Regulations since civil money penalties may be invoked (refer to the Civil Money Penalties Section of this Manual).

V. APPLICATIONS FOR RETIREMENT OF CAPITAL

Introduction

Refer to the current FDIC Statement of Policy on Capital in the Capital Section of this Manual.

There is concern that approval of a request to retire subordinated notes by a bank which is in danger of failure may in effect be granting preferred creditor status to the note holder. Consequently, unless a bank is in a condition which indicates it might fail within a reasonable time, the Regional Director should exercise delegated authority and approve the request.

Prior consent of the Corporation is required for any insured State nonmember bank (except a District bank) to reduce the amount or retire any part of its common or preferred capital stock, or retire any part of its capital notes or debentures. Adequacy of the remaining capital is the chief factor considered in acting upon applications for capital retirement or reduction. In granting or withholding consent, the Corporation must consider the six statutory factors: the financial history and condition of the bank; the adequacy of its capital structure; its future earnings prospects; the general character of its management; the convenience and needs of the community to be served and whether or not its corporate powers are consistent with the purposes of the FDI Act.

Section 18(l) of the Federal Deposit Insurance Act deals specifically with the subject of capital retirement. The FDIC's Legal Division has ruled that the provisions of this section also apply to capital retirements or reductions relative to the following: retirements or reductions which are part of another proposal for which a current application has been filed for Corporation approval; conversion of capital notes or debentures to an equivalent amount of common stock or preferred stock; conversion of preferred stock to an equivalent amount of common stock;

and repurchase and retention by a bank of its own capital as part of a stock option plan.

Capital Notes and Debentures

Insured State nonmember banks customarily seek the Corporation's consent to retire subordinated notes or debentures at the time of proposed issuance of such obligations.

The Legal Division is of the opinion that where a replacement of capital issues is clearly of a formalistic nature only, without an effective reduction in the amount of the bank's capital and with no change to the governing terms and conditions of the instruments themselves, the replacement should not be deemed to come within Section 18(l)(1) of the FDI Act.

All new subordinated note and debenture agreements must contain a statement to the effect that the prior consent of the FDIC is required before any portion of the debt can be retired. The purpose of including the statement is to assure that all parties involved, including future holders of the notes, are aware of the requirements of Section 18(l)(1). Where periodic mandatory payments are required, the agreement and the notes may include the additional statement that these particular mandatory payments have already been consented to by the FDIC, if such advance consent has, in fact, been given.

VI. APPLICATIONS FOR MERGERS

Introduction

It is the policy of the FDIC to preserve the soundness of the banking system and promote market structures conducive to competition. A proposed merger, consolidation, and purchase of assets and assumption of liabilities are all hereafter referred to collectively as "mergers".

Provisions of Law

Section 18(c) of the Federal Deposit Insurance Act (the "Act"), popularly known as the Bank Merger Act, provides that, except with the prior written approval of the FDIC, no insured depository institution may merge with any other insured depository institution, if the acquiring, assuming or resulting institution is to be a nonmember insured bank. The section also requires approval before an insured depository institution may merge with a noninsured bank or institution. In addition, the FDIC will consider in evaluating merger applications the requirements of the Community Reinvestment Act and the National Environmental Policy Act of 1969. The factors to be considered in granting or withholding approval are those enumerated in Section 18(c) of the "Act". Various sections of Part 303 of the FDIC's Rules and Regulations govern in large measure the administrative handling of "merger" applications, and also allows public access to the nonconfidential portions of the application file.

Paragraph (4) of Section 18(c) of the "Act" provides that, before acting on an application, the FDIC must request reports on the competitive factors involved from the Attorney General, the Comptroller of the Currency and the Board of Governors of the Federal Reserve System. These reports must ordinarily be furnished within 30 days, and the applicant will, if it so requests, be given an opportunity to submit comments to the FDIC respecting the contents of the competitive factor reports.

Paragraph (5) of Section 18(c) prohibits the FDIC from approving anticompetitive mergers. To establish that any anticompetitive effect is clearly outweighed in the public interest, the proponents must show that probable effect of the transaction in meeting convenience and needs is likely to benefit all seekers of banking services in the areas of competitive impact, rather than merely those who seek, for example, large and loan trust services, and that the expected benefit cannot reasonably be achieved through other, less anticompetitive means. The statute also requires the FDIC to consider in every case the financial and managerial resources and future prospects of the existing and proposed institutions as well as the convenience and needs of the community to be served.

Under Section 8(q) of the "Act", whenever the liabilities of an insured depository institution are assumed by another insured depository institution; the insured status of the institution whose liabilities are assumed terminates on the date of receipt by the FDIC of satisfactory evidence of the assumptions, and separate insurance of all assumed deposits terminates at the end of six months from the date the assumption takes effect or, in the case of any time

deposit, the earliest maturity after the sixth-month period.

Statement of Policy - Bank Merger Transactions

The FDIC Statement of Policy on Bank Merger Transactions was revised effective September 22, 1989.

The FDIC is prohibited by law from approving any merger that would tend to create or result in a monopoly, or which would further a combination, conspiracy or attempt to monopolize the business of banking in any part of the United States. Similarly, the FDIC may not approve a transaction whose effect in any section of the country may be to lessen competition substantially, or which in any other manner would be in restraint of trade. The FDIC may, however, approve any such transaction if it finds that the anticompetitive effects of the proposed transaction are clearly outweighed in the public interest by its probable effect in meeting the convenience and needs of the community to be served, for example, where approval of the merger may prevent the probable failure of one of the banks involved. In every case, the FDIC must also consider the financial and management resources and future prospects of the existing and proposed institutions, and the convenience and needs of the community to be served.

In evaluating the various factors prescribed and making the necessary judgments on proposed merger transactions, it is the intent and purpose of the FDIC to foster and maintain a safe, efficient and competitive banking system that meets the needs of all elements of the communities served. With these broad goals in mind, the FDIC will apply the specific standards listed in the Policy Statement in evaluating and deciding proposed bank merger transactions.

Procedures

Banks seeking the FDIC's consent to engage in a merger transaction must file a formal application with the FDIC on the appropriate form. The FDIC will not take final action on an application until notice of the proposed transaction is published in a newspaper or newspapers of general circulation in the appropriate community or communities, in accordance with the requirements of Section 303.6 of the FDIC's Rules and Regulations. Also, the FDIC will not approve an application unless and until stockholders of the merging institutions have approved the proposed transaction in accordance with State law and other applicable statutes by the required majority of stockholders entitled to vote on such matters, after adequate notice and disclosure.

In evaluating a merger application, the FDIC considers the following factors: the effect of the transaction on competition; the convenience and needs of the community to be served, including compliance with the Community Reinvestment Act; the financial and managerial resources of the merging banks, including their condition, capital adequacy, the quality of management, the existence of insider transactions, and the nature and extent of any inducement to any officer, director, or employee to promote or encourage the merger; and, the future prospects, including probable earnings performance. The last two elements are referred to collectively as banking factors.

In order to determine the effect of the proposed merger on competition, it is necessary to identify the relevant geographic market. The delineation of such market can seldom be precise, but realistic limits should be established so the effect of the merger upon competition can be properly analyzed. The FDIC recognizes that different banking services may have different relevant geographic markets. However, the market should not be drawn so expansively as to cause the competitive effect of the merger to seem insignificant. Conversely, the market should not be drawn so narrowly as to place competitors in entirely different markets. After the relevant geographic market has been identified, the competitive effect of the proposed merger can be analyzed. A merger not having a substantially adverse competitive effect may nevertheless be disapproved if, after considering the banking factors, the Corporation concludes that the resultant bank will have inadequate capital, unsatisfactory management, or poor earnings prospects.

A revised policy statement adopted by the Board of Directors of the FDIC on October 25, 1977, as amended September 8, 1980 requires that legal fees and other expenses be fully accountable, identified as to source and receive comment as to reasonableness. The Corporation requires full disclosure to all directors and shareholders of any fee in excess of $5,000 paid to insiders or their

interests.

Although the appropriate application must be filed with the Corporation and statutory factors are considered in the case of "phantom bank mergers" (mergers or other transactions involving an existing bank and a newly chartered bank or corporation for the purpose of corporate reorganization) and other corporate reorganizations (transactions involving banks controlled by the same holding company or transactions involving banks or their subsidiaries), these types of transactions normally do not have any effect on competition or otherwise have significance under relevant statutory standards set forth in Section 18© of the FDI Act. The guidelines set forth above for "mergers" have only general applicability and may have no applicability depending on the specific circumstances involved in individual transactions.

VII. Applications by Undercapitalized Depository Institutions to Accept, Renew or Rollover Brokered Deposits

Provisions of Law

Section 224 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 added section 29 to the FDI Act, prohibiting the acceptance, renewal or rollover of brokered deposits by any undercapitalized insured depository institution (bank or savings association) except on specific application to and waiver of the prohibition by the FDIC.

Section 337.6 of the FDIC's regulations provides guidance and detail on when an institution is considered undercapitalized, when certain deposits are considered "brokered" for purposes of the prohibition, and the circumstances under which a waiver from the prohibition may be obtained.

The regulation takes a broad view of when an institution is considered undercapitalized and a narrow view of the circumstances under which a waiver may be obtained with the result and expectation that such institutions will not accept new brokered deposits and over some reasonable time frame all undercapitalized depository institutions utilizing brokered deposits will have to either meet applicable capital standards or eliminate brokered deposits from their books.

Procedures

Undercapitalized insured depository institutions may file waiver applications under section 337.6 with the Regional Office where they are headquartered. Institutions may apply for a waiver in letter form or on an optional application form. Each application received should be reviewed for completeness and sufficiency of the data provided with respect to each of the elements listed in section 337.6(d) of the rule. When these are deemed sufficient, the institution should be notified that its application has been accepted. The institution's principal federal and any state regulator, as appropriate, should be consulted by telephone or letter for their comments and any recommendations they may wish to make. The application, together with all related and supporting data, including the recommendation of the Regional Director, should be forwarded to the Washington Office marked for the attention of the Assistant Director, Office of Supervision and Applications.

Authority is delegated to the Director, Division of Supervision, to approve or deny properly filed applications for a waiver of the prohibition on the acceptance, renewal or rollover of brokered deposits. Authority is also delegated to Regional Directors or Deputy Regional Directors to temporarily approve such applications where the applicant is requesting to continue accepting brokered deposits that would not significantly increase the average maturity and volume of its brokered deposits or, if it does increase its volume of brokered deposits, the increase in brokered deposits is to replace run-off of other types of existing funding. All approvals granted at the regional office level under this delegation must expire within ninety days, and must include a condition that the approval is temporary, pending a final decision, and may be withdrawn at any time.

Temporary approvals granted pursuant to the regional delegation are intended to permit the institution to operate, but not grow, while the waiver applications are being processed.

Enforcement of the provisions of this law and regulation rests with each appropriate federal regulatory agency for institutions under their

supervision. Most waivers, if granted, will contain several conditions. In any examination in which FDIC examiners participate, they should report any noted violations of the law, regulation or imposed conditions. Whenever violations are noted, appropriate formal or informal administrative action should be taken to ensure that the institution immediately ceases such violations and does everything practicable to rid itself of brokered deposits accepted in violation of the prohibition. Recommending that a previously granted waiver be rescinded or modified might also be considered. Progress reports should be requested from any nonmember bank found to be in violation, with more forceful enforcement action initiated as appropriate.

VIII. Policy Statement on Encouragement and Preservation of Minority Ownership of Financial Institutions

Introduction

In recognition of the unique status of minority-owned depository institutions in the financial system, it is the policy of the Division of Supervision (DOS) to proactively preserve minority ownership of financial institutions and to encourage minority participation in the management of financial institutions. This policy is intended to be consistent with the FDIC's broader mission of preserving the soundness of the banking system and promoting fair market structures conducive to competition and community service.

For the purposes of this policy statement, the term minority-owned institution means an FDIC-insured depository institution where more than 50% of the voting stock is owned or controlled by minority individuals or organizations, or in the case of a mutual depository institution, the majority of the Board of Directors, account holders and the community which it serves are members of a minority group. The term "minority" means any black American, Native American, Hispanic American, or Asian American.

Statutory Requirements

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) contains several provisions relating to the preservation of minority ownership of financial institutions. These statutes provide a framework for this policy statement.

Section 13(k) of the FDI Act deals with emergency acquisitions of distressed savings associations. Section 13(k)(2)(B) addresses the acquisition of minority-controlled depository institutions by stating: "the Corporation shall seek an offer from other minority-controlled depository institutions before seeking an offer from other persons or entities.

Section 13(f)(12) of the FDI Act eliminates the $500,000,000 asset cut-off for acquisition of a distressed minority-controlled bank by an out-of-state minority-controlled depository institution or depository institution holding company.

Section 308 of FIRREA sets goals to preserve minority ownership of financial institutions. These goals are set out as:

1. *Preserving the number of minority depository institutions;*
2. *Preserving the minority character in cases of merger or acquisition;*
3. *Providing technical assistance to prevent insolvency of institutions not now insolvent;*
4. *Promoting and encouraging creation of new depository institutions; and*
5. *Providing for training, technical assistance, and education programs.*

Discussion

The Division of Supervision becomes involved in the creation of new minority ownership through its responsibility for acting on applications for federal deposit insurance and mergers and reviewing notices of acquisition of control. For those minority applicants who are not familiar with the required laws, procedures or forms, technical expertise and assistance should be made available through DOS Regional Offices.

One very effective method of preserving minority ownership is to maintain the health of existing minority-owned depository institutions. In this regard, DOS is committed to a program of regular examination of all banks for which it has primary supervisory responsibility. This examination program is intended to detect deteriorating trends and to work with management to correct them. Correction of any adverse trends in institutions normally is handled through regular supervisory channels. In the event that management is unable to effect correction

because of a lack of resources or technical expertise, DOS will provide assistance where practical. Additionally, DOS encourages other depository institutions to be available to provide technical expertise to minority-owned institutions.

Training, education and technical assistance are available through the FDIC in such areas as call report preparation, consumer affairs and civil rights, and accounting. FDIC personnel generally are available for attendance at conferences or seminars dealing with issues of concern to minority groups.

Procedures and Related Matters

Applications - Notices of acquisition of control and applications for deposit insurance and merger from minority-owned institutions will be submitted to the appropriate regional office and processed under established procedures. Those applications which involve creation or preservation of minority ownership also will be considered in the context of the effect of the transaction on the goal of preserving minority ownership. Technical assistance in the completion of the documentation of these applications is available upon request from the regional office.

Operating Institutions in Need of Assistance - Through its normal supervision, the FDIC will be aware of institutions in need of remedial or preventative attention. Field examiners and regional office staff will make suggestions and offer assistance, which an institution is free to accept. Institutions are also urged to make their needs known to the Regional Director who will do all they can to help. To the extent possible, the FDIC will consider invitations to participate in seminars, conferences and workshops directed to minority audiences.

Request for Financial Assistance - Requests from minority groups for assistance in resolving a failing minority-owned depository institution will be considered at the same time as assistance requests or failing bank bids received from non-minority groups; however, preference generally will be given to a minority group proposal. Technical assistance in preparing these applications is available upon request.

Failing Banks - In the event a minority-owned bank deteriorates into a failing condition, a list of eligible bidders is compiled. Generally, preference will be given to qualified minority bidders located 1) in the same local market area, 2) in the same state, and 3) nationwide. Trade associations will be contacted for names of possible interested parties which may be contacted. Groups interested in becoming bidders must have appropriate clearance from other responsible regulatory agencies.